Tax incidence — California

ABAG PROPERTY TAX RELIEF COMMITTEE

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If the role of the property tax in local revenue structures is to be reduced in the future, the necessary replacement revenue must come from local nonproperty taxes, from larger transfer payments from the State and/or Federal governments, or from a combination of these.

In evaluating alternatives, a number of questions seem to me to be of importance.

With regard to local nonproperty taxes: What are the yield potentials of various local nonproperty taxes? How sensitive are these taxes to economic growth? How equitable are these taxes compared to the property tax? What administrative and enforcement problems and taxpayer compliance problems are likely to be encountered?

With regard to State and Federal transfer payments, the most important consideration seems to me to be the extent to which an acceptable degree of local autonomy can be maintained.

Let me comment briefly on each of these questions. . .

There appears to be quite general agreement that additional local revenue sufficient in amount to permit significant property tax relief must come mainly from the nonproperty taxes with relatively high yield potential - local sales or income taxes.

Adoption of local taxes not now widely used in California - e.g., utility user and admissions taxes - and revamping of business license taxes can produce some additional revenue to reduce dependence on the property tax, but in terms of the overall problem, the revenue potential from these sources is relatively modest.

Moreover, independent use of a multiplicity of taxes by governments of limited territorial jurisdiction creates problems of its own. Many local governments are smaller than the economic complex of which they form a part and local taxes levied independently may affect competitive business relationships in the entire economic area involved. While the influence of taxes on business decisions is sometimes exaggerated, this consideration cannot be ignored by local legislative bodies. Difficulties of administration and enforcement are also frequently magnified in limited taxing jurisdictions.

The choice appears to be between nonproperty taxes with relatively high yield potential as sources of replacement revenue to permit property tax relief and a hodgepodge of independent nonproperty taxes the aggregate yield of which can at best be only modest.

A closely allied question is the sensitivity of various taxes to economic growth. One of the main explanations of the financial difficulties of local governments is that the demand for services for which they are responsible is highly sensitive to economic growth while their traditional revenue sources are relatively less sensitive. Thus, they find themselves in a bind from which they have not as yet been able to extricate themselves. A number of studies establish clearly that the yield of an income tax increases substantially more than proportionately as Gross National Product rises whereas property and sales taxes increase only about proportionately with economic growth. This is a relationship that certainly warrants consideration in connection with any proposal for replacement revenue to permit property tax relief.

Evaluation of taxes on equity grounds requires knowledge of where the tax burden actually falls in terms of individuals or taxpaying units, some criterion of taxpaying capacity against which the burden is compared, and a judgment as to the manner in which tax burdens should vary with differences in such capacity. The latter question obviously involves a value judgment.

Economists typically distinguish between horizontal equity - that is, equity among those who are similarly situated - and vertical equity in the sense of equity among those in different economic circumstances.

The research report recently issued by the Advisory Commission on Tax Reform provides convincing evidence that the property tax allocates tax burdens in a haphazard fashion and thus generates a large number of interpersonal inequities, most of which seem to be avoidable only at prohibitively high administrative and compliance costs. Interpersonal inequities will obviously not be corrected if part of the revenue now coming from the property tax is replaced by taxes characterized by similar or more pronounced interpersonal inequities. This again is a matter that warrants consideration in connection with any proposal for replacement revenue to permit property tax relief.

The effects of various taxes on local economies - that is, the effects on decisions of individuals as to where they will live and work and of businesses as to where they will locate - unfortunately are all too frequently difficult to determine with any high degree of precision. But there is a considerable body of experience that can be drawn upon to evaluate various taxes in terms of the likelihood that they will have adverse economic effects. Even though evaluations may leave much to be desired, they at least provide rough guidelines in choices among alternatives.

There is probably little disagreement with the proposition that any local tax should be capable of effective administration and enforcement at acceptable costs to the government involved and that compliance costs to taxpayers in determining tax liability should be reasonable in amount. Here again there is considerable experience upon which to draw in the choice among alternatives.

Relieving the tax load on property ownership by diversification of the local tax base is an appealing goal, but it should be recognized that such diversification does not necessarily in and of itself insure improvement in the local tax structure. The crucial question is the form which diversification takes.

Assuming the total tax borne by taxpayers as a whole will be the same, diversification may or may not change the composition of the taxpaying public to any appreciable degree. Little will be gained if the property owner finds his property tax bill reduced but pays an equivalent amount or more in non-property taxes.

On the other hand, diversification of the local tax base that brings about a change in the composition of the taxpaying public can achieve effective property tax relief. But whether this is a worthwhile result depends on the form which diversification takes. The overall result may in fact be detrimental if nonproperty taxes have adverse effects on the local economy or accentuate rather than reduce interpersonal inequities or cannot be administered effectively at reasonable cost. Thus, evaluation among alternatives presents some tough problems.

These problems are accentuated in an area such as this where the benefits of local services often flow across the boundaries of taxing units and where tax differentials if sufficiently great can be a factor in decisions of individuals and business firms.

Independent action by separate governmental units within a metropolitan area can lead to uneconomic competition for industrial and commercial facilities, can interfere with use and development of land in ways which would improve the environment of the whole metropolitan area, and can result in adoption of local plans which are inconsistent with each other.

If uneconomic locational decisions are to be avoided and tax evasion held to a minimum, taxes to provide replacement revenue for property tax relief ideally should cover a large enough area to contain almost all alternative locations and should be levied on a uniform basis throughout the area.

Interlocal cooperation among jurisdictions making up an integrated economic area would thus appear to be essential, although action of this kind may be difficult, particularly where revenue pressures vary and taxes have an unequal impact among areas.

Various proposals for increased State and Federal assistance to local governments are now under discussion. Those who support greater reliance on grants-in-aid and sharing of centrally collected taxes argue that these devices give local governments access to the yield of taxes which they cannot administer effectively on their own, that the waste of dual administration is eliminated, and that, in the case of grants-in-aid, there is opportunity to adjust for differences in taxable resources relative to expenditure needs. These advantages may be conceded, but the problem remains of devising interlocking fiscal arrangements that will maintain an acceptable degree of local autonomy. Whatever may be said against the property tax, it at least provides local governments with an independent source of revenue that can be varied from year to year in response to changing demands for local governmental services.

I referred earlier to a research report recently issued by the Governor's Advisory Commission of Tax Reform under the chairmanship of State Controller Flournoy. While the title of the report is "Agenda for Local Tax Reform," it deals with various possible sources of local tax revenue which might be

used to supplement the property tax. It should be most helpful, therefore, in the deliberations of this Committee.

I would judge that any evaluation of alternative measures to achieve property tax relief requires a look at the overall results, and progress will not be made unless the alternatives recommended are superior to the property tax itself. Thus property tax relief and tax reform would seem to go hand-in-hand.